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UNITED STATES DISTRICT COURT  
NORTHERN DISTRICT OF CALIFORNIA

15 CITY OF WESTLAND POLICE AND FIRE  
16 RETIREMENT SYSTEM AND PLYMOUTH  
COUNTY RETIREMENT SYSTEM, On Behalf  
of Itself and All Others Similarly Situated,

**Plaintiff,**

V.

19 SONIC SOLUTIONS, DAVID C. HABIGER,  
20 ROBERT J. DORIS, A. CLAY LEIGHTON,  
21 MARY C. SAUER, MARK ELY, ROBERT M.  
GREBER, PETER J. MARGUGLIO and R.  
WARREN LANGLEY.

## Defendants.

Case No.: C 07-5111(JSW)

## CLASS ACTION

DEFENDANTS' NOTICE OF  
MOTION AND MOTION TO  
DISMISS THE CONSOLIDATED  
CLASS ACTION COMPLAINT;  
MEMORANDUM OF POINTS AND  
AUTHORITIES IN SUPPORT  
THEREOF

Date: September 5, 2008  
Time: 9:00 a.m.  
Trial Date: None Set

## The Honorable Jeffrey S. White

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1 TO ALL PARTIES AND THEIR COUNSEL OF RECORD:

2       **PLEASE TAKE NOTICE** that on September 5, 2008, at 9:00 a.m., in the United  
 3 States District Court for the Northern District of California, located at 450 Golden Gate  
 4 Ave., San Francisco, California, before the Honorable Jeffrey S. White in Courtroom 2,  
 5 17th Floor, Defendants Sonic Solutions (“Sonic”), David C. Habiger, Robert J. Doris, A.  
 6 Clay Leighton, Mary C. Sauer, Mark Ely, Robert M. Greber, Peter J. Marguglio and R.  
 7 Warren Langley (collectively referred to as “Defendants”) will and hereby do move the  
 8 Court for an order dismissing with prejudice the Consolidated Class Action Complaint in  
 9 this action (“Complaint”) pursuant to Rules 9(b) and 12(b)(6) of the Federal Rules of Civil  
 10 Procedure and the Private Securities Litigation Reform Act of 1995, 15 U.S.C. §§ 78u-4 *et*  
 11 *seq.* (“PSLRA”), on the grounds that the allegations in the Complaint fail to state a claim  
 12 upon which relief can be granted.

13       This Motion is based on this Notice of Motion and Motion, the attached  
 14 Memorandum of Points and Authorities, the Request for Judicial Notice and exhibits  
 15 attached thereto, all pleadings and papers on file in this action, and such additional evidence  
 16 and authority as may be offered at or before the time of oral argument on this Motion.

17       **STATEMENT OF ISSUES (Civil Local Rule 7-4(a)(3))**

18       1.       Whether the City of Westland and the Plymouth County Retirement System  
 19 (“Plaintiffs”) fail to adequately plead facts establishing a “cogent and compelling” inference  
 20 of scienter as required by *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499,  
 21 2510 (2007), the PSLRA and Rule 9(b) of the Federal Rule of Civil Procedure so that their  
 22 securities fraud claim against all Defendants under Section 10(b) of the Securities Exchange  
 23 Act of 1934 (the “Exchange Act”) and Rule 10b-5 promulgated thereunder should be  
 24 dismissed?

25       2.       Whether Plaintiffs fail to state a Section 10(b) claim against Defendants Ely,  
 26 Greber, Langley, and Marguglio where:

27           (a)      the Complaint fails to allege with the required particularity that these  
 28

1 Defendants were involved in the preparation of the allegedly misleading statements,  
2 and thus, fails to attribute any misstatements to these four individuals; and

3 (b) the Complaint purports to state a claim for “scheme liability” by  
4 merely recasting the misrepresentation claim?

5 3. Whether Plaintiffs fail to state a Section 20(a) control person liability claim  
6 against all Defendants under Section 20(a) of the Exchange Act where Plaintiffs fail to  
7 plead a predicate violation of the securities laws?

8 4. Whether Plaintiffs fail to state a Section 20(a) control person liability claim  
9 against Sonic where Sonic is an entity that cannot “control” its employees?

10 5. Whether Plaintiffs fail to state a Section 20(a) control person liability claim  
11 against the Individual Defendants where the Complaint fails to allege with the required  
12 particularity that the Individual Defendants exercised actual power or control over Sonic?

13 6. Whether Plaintiffs fail to state insider trading claims under Section 20A of the  
14 Exchange Act against the Individual Defendants where Plaintiffs fail to adequately plead a  
15 primary violation of the securities laws?

16 7. Whether Plaintiffs fail to state insider trading claims under Section 20A of the  
17 Exchange Act against Defendants Sauer, Ely, and Marguglio where the Complaint fails to  
18 allege that these Defendants made any stock sales that were “contemporaneous” with  
19 Plaintiffs’ sales?

20 8. Whether Plaintiffs fail to state insider trading claims under Section 20A of the  
21 Exchange Act against Defendants Langley and Greber where the alleged sales made by  
22 these Defendants were not “contemporaneous” with Plaintiffs’ sales?

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# MEMORANDUM OF POINTS AND AUTHORITIES

## I. INTRODUCTION

Plaintiffs assert that Sonic and certain of its officers and directors have violated the federal securities laws by misrepresenting and concealing a scheme to issue backdated stock options. Specifically, Plaintiffs claim that the Company falsely represented that stock options were granted at fair market value and that Sonic's Forms 10-Q and Forms 10-K during the class period consequently under-reported the Company's expenses, thereby overstating the Company's reported earnings or under-stating its reported losses. Plaintiffs point to the Company's Form 10-K filed earlier this year with the Securities and Exchange Commission (the "SEC"), which contained restated financial statements for prior periods (the "Restatement"), as an admission that the Company's financial statements throughout the class period were materially false and misleading.

Although the Company’s Restatement may reflect an acknowledgement—after a long and careful review by the Audit Committee—that the Company’s grant processes were weak and that grant documentation was inadequate in some instances, the Audit Committee explicitly concluded that no one at the Company had engaged in any intentional wrongful conduct or had any knowledge that the Company’s accounting for options violated GAAP. The Complaint—replete with newspaper articles about other companies’ backdating activities and extensive quotes from Sonic’s public filings about its option grants and investigation—is absolutely devoid of facts from which any reasonable inference could be drawn that Defendants deliberately defrauded shareholders.<sup>1</sup>

As the Supreme Court made clear just last term in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2510 (2007), the Complaint must allege facts that give rise to a strong inference of scienter which is “more than merely ‘reasonable’ or ‘permissible’—it must be cogent and compelling . . . in light of other explanations.” Here, the only fact plead

<sup>1</sup> In fact, Plaintiffs rushed to file a case asserting securities fraud claims before the Audit Committee had even concluded its investigation, based on the mere announcement that such an investigation was underway and that the Company had concluded that grant documentation was insufficient.

1 in the Complaint to support an inference of scienter is the existence of the Restatement:  
 2 however, the equally and indeed more compelling inference fairly drawn from the  
 3 Restatement is—consistent with the conclusions of the Audit Committee as spelled out in  
 4 that Form 10-K—that the Company’s grant approval processes and documentation were  
 5 weak, not that there was any intentional backdating or knowledge of improper accounting  
 6 for stock options. Accordingly, Plaintiffs’ Complaint fails to adequately plead scienter and  
 7 their Section 10(b) claim must be dismissed.

8 Plaintiffs’ claims for control person liability and insider trading under Section 20 of  
 9 the Exchange Act also should be dismissed. First, both of these claims fail because they  
 10 require a predicate violation of the federal securities laws and because Plaintiffs have failed  
 11 to plead a Section 10(b) violation, they also cannot assert claims under Section 20(a).  
 12 Moreover, Plaintiffs have failed to specifically plead facts establishing that any of the  
 13 Individual Defendants exercised control over the Company. And with regard to Plaintiffs’  
 14 insider trading claim under Section 20A, they have not established a right to relief because  
 15 Plaintiffs have not alleged that they purchased Sonic securities contemporaneously with  
 16 many of the Individual Defendants’ purported sales.

17 **II. STATEMENT OF FACTS**

18 **A. Description of the Defendants.**

19 Sonic, located in Novato, California, is a California corporation that develops and  
 20 markets computer software related to digital media, such as data, photographs, audio, and  
 21 video in digital formats. Compl. ¶ 59. Sonic became a public company in February 1994  
 22 and is traded on The Nasdaq Global Select Market. RJD Ex. A, at 14.<sup>2</sup>

23 Defendants Robert J. Doris and Mary C. Sauer co-founded Sonic in 1986. Doris has  
 24 been the Chairman of the Board of Directors since the Company’s formation. Compl. ¶ 61.  
 25 He also served as the CEO of Sonic from 1986 until he resigned from the position in  
 26 September 2005. *Id.* ¶ 61. Sauer has served as a Director and Company Secretary since its

27  
 28 <sup>2</sup> All “RJD Ex. \_\_” citations in the brief refer to the exhibit attached to Sonic’s Request for Judicial  
 Notice in Support of Motion to Dismiss, filed concurrently.

1 founding. *Id.* ¶ 63. She also served as Vice President from 1986 to September 2005 and as  
 2 the Senior Vice President of Marketing and Sales from February 1993 to September 2005.  
 3 *Id.*

4 Defendants David C. Habiger, A. Clay Leighton, and Mark Ely are executive officers  
 5 of Sonic (collectively referred to as the “Officer Defendants”). Habiger joined Sonic in  
 6 1993, and became its President and Chief Operating Officer in April 2005. *Id.* ¶ 60. In  
 7 September 2005, he succeeded Robert Doris as the CEO of Sonic. *Id.* Leighton joined  
 8 Sonic in 1992 as a Vice President of Finance and later became the Senior Vice President of  
 9 Worldwide Sales and Finance. He served as the Company’s Chief Financial Officer from  
 10 January 1999 to February 2008. *Id.* ¶ 62. Ely joined Sonic in 1992 and in September 2006,  
 11 became the Company’s Executive Vice President, Strategy. *Id.* ¶ 64.

12 Defendants Robert M. Greber, R. Warren Langley, and Peter J. Marguglio  
 13 (collectively referred to as the “Outside Directors”) are outside directors and members of  
 14 various Board Committees. These directors joined Sonic’s Board in August 1993, August  
 15 1996 and June 2001, respectively. *Id.* ¶¶ 65, 66, 67.

16 **B. Sonic’s Stock Option Program, Historical Review and Restatement**

17 Like many other technology companies, Sonic awards stock options as an integral  
 18 part of the compensation provided to employees, officers and directors. Compl. ¶ 17.  
 19 During the class period, the Company had various Stock Option Plans that governed the  
 20 terms on which Sonic could issue options. *See, e.g., id.* ¶ 19 and 21. From 1998 until  
 21 September 2005, Doris, as CEO, was authorized to grant stock options. RJD Ex. A, at 7.  
 22 On September 23, 2005, the board adopted a resolution creating an employee options  
 23 subcommittee comprised of the CEO, Habiger, and the CFO, Leighton, to administer grants  
 24 to recipients other than directors and executive officers. *Id.* Directors typically received  
 25 grants at preset times, normally at the meeting of the Company’s board of directors  
 26 immediately following each annual shareholder meeting. *Id.*

27 In the spring of 2006, journalists and academics identified several companies where  
 28 it appeared that stock option grants may have been issued on favorable dates and questioned

1 whether these companies had appropriately accounted for those grants. Compl. ¶¶ 42-44.  
 2 Some theorized that executives at these companies might have deliberately manipulated  
 3 grant documentation to suggest that grants were made at earlier dates when stock prices  
 4 were lower, i.e., backdating, so that recipients realized an immediate gain. *Id.* ¶¶ 42-46.

5 In the wake of the extensive press reports challenging perceived widespread  
 6 backdating and SEC pronouncements regarding stock option accounting, Sonic decided to  
 7 review its historical stock option practices. On February 1, 2007, the Company issued a  
 8 press release announcing that it had commenced a voluntary review of its historical and  
 9 current stock option grant practices and related accounting. Compl. ¶ 46.

10 The stock option review was conducted by the Audit Committee, comprised solely of  
 11 independent directors, with the assistance of legal counsel and outside consultants. RJD Ex.  
 12 A, at 5. The Audit Committee and its advisors conducted an extensive review, including an  
 13 assessment of Sonic's options granting policies and procedures, internal records, supporting  
 14 documentation, e-mail communications, and interviews of Company personnel. *Id.*

15 On February 26, 2008, the Audit Committee reported the results of its investigation.  
 16 Compl. ¶ 52 and RJD Ex. A. The Audit Committee found that the Company's employee  
 17 option granting processes were informal and that "it appears that insufficient attention was  
 18 devoted to ensuring that grant documentation was prepared or finalized by the Record  
 19 Date." RJD Ex. A, at 7. Accordingly, the Audit Committee concluded that for a large  
 20 portion of the employee options issued prior to September 23, 2005, "there is little or no  
 21 contemporaneous grant-specific documentation that satisfies the requirements for  
 22 'measurement dates' under APB No. 25 and that would allow [Sonic] to maintain the  
 23 original grant date used for accounting purposes (the 'Record Date')."*Id.* at 6.<sup>3</sup> The Audit  
 24 Committee, however, did not find any evidence that management backdated grants or

25  
 26 <sup>3</sup> Founders and directors grants were generally not determined to have record dates that required  
 27 adjustment. In one case where full minutes were not available, certain measurement date adjustments were  
 28 made based upon the supporting documentation that was available. Additionally, the Audit Committee  
 identified two instances where written consents were used and the Company deemed the measurement date  
 to be the date of the last signature. In both instances the change in measurement date was one day. RJD Ex.  
 A, at 7.

1 committed any other misconduct.

2 In fact, the Audit Committee expressly concluded that there was *no intentional*  
 3 *wrongful conduct* by Sonic employees, officers, or directors, and that *there was no evidence*  
 4 *that they “had any knowledge that their handling of option grants violated stock option*  
 5 *accounting rules.”* RJD Ex. A, at 7-8 (emphasis added). To the extent Sonic personnel  
 6 authorized grants using incorrect or unreliable dates, the Audit Committee found “*no*  
 7 *evidence of an intent to purposefully circumvent stock option accounting rules or to*  
 8 *otherwise inaccurately report the financial results of the Company* during the Review  
 9 Period.” *Id.* at 8 (emphasis added).

10 The Audit Committee also did not find any evidence that the officers or directors  
 11 responsible for the Company’s stock administration had taken steps to provide themselves  
 12 with options at better prices than those granted to other employees. *Id.* at 7. Moreover, the  
 13 Audit Committee found no indication of intent by those with responsibility for selecting  
 14 grant dates to benefit personally at the expense of the Company. *Id.* at 6-7.

15 Based on the results of the Audit Committee’s extensive review, on February 26,  
 16 2008, the Company filed the Restatement, which restated its prior financial statements by  
 17 \$29 million to adjust for compensation expenses relating to stock option grants. Compl.  
 18 ¶¶ 2, 52.

19 **C. Plaintiffs and Their Complaints.**

20 Plaintiff, the City of Westland Police and Fire Retirement System (“the City of  
 21 Westland”), filed its initial complaint on October 4, 2007—eight months after the Company  
 22 announced its voluntary stock option review.<sup>4</sup> Plaintiff purported to bring suit on behalf of  
 23 all Sonic shareholders who purchased securities between October 4, 2002 and May 17,  
 24 2007. Plaintiff alleged that the Company “had been manipulating stock option grant dates

25

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26 <sup>4</sup> Before plaintiff filed this shareholder class action, a number of derivative lawsuits were filed in  
 27 both state and federal court alleging breach of fiduciary duty and other claims against Sonic’s senior officers  
 28 and directors. Counsel for Plaintiffs herein, initially filed a derivative claim on March 15, 2007 on behalf of  
 plaintiff Ralph D. Wilder in the United States District Court for the Northern District of California which  
 was subsequently dismissed voluntarily on September 6, 2007.

1 to benefit insiders which caused the Company's proxy statements and Forms 10-Q and  
 2 Forms 10-K to be materially false and misleading." First Compl. ¶ 66(a). This complaint  
 3 asserted claims under Sections 10(b), Section 14(a), and Section 20(a) of the Exchange Act  
 4 against Sonic, Doris, Sauer, Habiger, Leighton and Ely.

5 Following the Company's Restatement in February 2008, the City of Westland  
 6 joined by the Plymouth County Retirement System filed a Consolidated Class Action  
 7 Complaint on March 21, 2008. According to Plaintiffs' consolidated complaint, Defendants  
 8 engaged in a fraudulent scheme that involved the knowing manipulation of stock option  
 9 grants to Company officers, directors and employees. Plaintiffs allege that Defendants  
 10 falsely represented that stock options were granted at fair market value, consistent with the  
 11 provisions of Sonic's stock option plans. Plaintiffs further allege that Sonic's Forms 10-Q  
 12 and Forms 10-K during the class period under-reported the Company's expenses and  
 13 thereby over-stated the Company's reported earnings or under-stated the reported losses.  
 14 Plaintiffs claim that the Company's Restatement amounts to an admission that the  
 15 Company's financial statements throughout the class period were materially false and  
 16 misleading. Compl. ¶ 2.

17 Plaintiffs' consolidated complaint not only names Doris, Sauer, Habiger, Leighton  
 18 and Ely as well as the Company as defendants, but also asserts claims against certain  
 19 outside directors during the class period: Greber, Marguglio and Langley. Plaintiffs allege  
 20 that the CEO and the Board were responsible for administering the Company's stock option  
 21 plans. Compl. ¶ 24. The Complaint further alleges that because of their positions with the  
 22 Company, the Individual Defendants had "the power and authority to control the contents"  
 23 of Sonic's public filings and that "because of their positions," they further "knew that the  
 24 adverse facts specified [in the Complaint] had not been disclosed to and were being  
 25 concealed from the public and that the representations being made were then materially  
 26 false and misleading." *Id.* ¶ 68. The Complaint asserts three claims under the federal  
 27 securities laws: (1) violation of Section 10(b) of the Exchange Act against all Defendants;  
 28 (2) violation of Section 20(a) of the Exchange Act (controlling person liability) against all

1 Defendants; and (3) violation of Section 20A of the Exchange Act (insider trading claims)  
 2 against the Individual Defendants.<sup>5</sup>

3 **III. SUMMARY OF ARGUMENT**

4 The Court should grant Defendants' Motion to Dismiss Plaintiffs' First Claim  
 5 asserting violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated  
 6 thereunder. To state a claim under Section 10(b) and Rule 10b-5, a plaintiff must plead: (1)  
 7 a material misrepresentation or omission; (2) scienter; (3) in connection with the purchase  
 8 or sale of a security; (4) reliance; (5) economic loss; and (6) loss causation. *See, e.g.,*  
 9 *Stoneridge Inv. Partners, LLC v. Scientific-Atlanta, Inc.*, 522 U.S. ---, 128 S. Ct. 761  
 10 (2007); *Dura Pharm., Inc. v. Broudo*, 544 U.S. 336, 341 (2005). Rule 9(b) of the Federal  
 11 Rules of Civil Procedure and the PSLRA further require that plaintiffs plead these elements  
 12 by alleging particular facts "specify[ing] each statement alleged to have been misleading,  
 13 the reason or reasons why the statement is misleading, and, if an allegation regarding the  
 14 statement or omission is made on information and belief, the complaint shall state with  
 15 particularity all facts on which that belief is formed." Section 21D(b)(1)(B) of the PSLRA;  
 16 *see also Ronconi v. Larkin*, 253 F.3d 423, 429 (9th Cir. 2001). The Complaint falls far  
 17 short of pleading a Section 10(b) violation with the requisite specificity.

18 *First*, Plaintiffs have failed to allege facts giving rise to a compelling inference of  
 19 scienter. In order to survive a motion to dismiss, the inference of scienter plead by  
 20 Plaintiffs must be "cogent and compelling." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*,  
 21 127 S. Ct. 2499, 2510 (2007). In assessing scienter, courts must consider all reasonable  
 22 inferences that can be taken from the complaint, including inferences that are unfavorable to  
 23 plaintiffs. *See Gompper v. VISX, Inc.*, 298 F.3d 893, 897 (9th Cir. 2002).

24 Here, Plaintiffs allege that the Individual Defendants—simply by virtue of their  
 25 position at the Company, their access to information, and their routine corporate duties—  
 26 knowingly participated in a backdating scheme and/or its concealment. There are no  
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28 

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<sup>5</sup> Plaintiffs apparently have dropped their claim under Section 14.

1 particular facts alleged regarding each individual defendant establishing knowing  
 2 participation in any backdating scheme or intentional accounting violations. While  
 3 Plaintiffs point to the Restatement as evidence of materially misleading statements, as  
 4 reflected in the Restatement, the Audit Committee expressly concluded that there was no  
 5 evidence of intentional wrongdoing. Because Plaintiffs have failed to allege facts giving  
 6 rise to an inference of scienter on the part of any Individual Defendant, they also have not  
 7 sufficiently alleged scienter on the part of the Company.

8 *Second*, the Complaint fails to adequately attribute any misleading statement or  
 9 omission to Defendants Ely and the three Outside Directors (Greber, Marguglio and  
 10 Langley). Ely is not alleged to have signed any of the Company's public filings and the  
 11 Complaint does not allege specific facts demonstrating the role that any of the alleged  
 12 Outside Directors played in the preparation of the Company's statements. Because the  
 13 Complaint fails to attribute any misstatement to Defendants Ely and the Outside Directors,  
 14 they may be liable under Section 10(b) only if Plaintiffs have stated a claim under  
 15 subsections (a) and (c), which together create what has become known as "scheme"  
 16 liability. However, scheme liability must be based on conduct that goes beyond the making  
 17 of false statements. *In re Royal Dutch/Shell Transp. Sec. Litig.*, No. 04-374, 2006 WL  
 18 2355402, at \*8 (D.N.J. Aug. 14, 2006); *JHW Greentree Capital, L.P. v. Whittier Trust Co.*,  
 19 No. 05 Civ. 2985 HB, 2005 WL 3008452, at \*7 (S.D.N.Y. Nov. 10, 2005). Because  
 20 Plaintiffs have failed to allege any misconduct in the Complaint beyond the alleged  
 21 misstatements, they cannot assert a valid Section 10(b) claim against Ely and the Outside  
 22 Directors.

23 *Third*, Plaintiffs' second cause of action fails to state a claim for control person  
 24 liability under Section 20(a) of the Exchange Act. Because the Complaint fails to  
 25 adequately allege a primary violation under Section 10(b) for the reasons set forth above, it  
 26 also fails to plead control person liability under Section 20(a). *In re U.S. Aggregates, Inc.*  
 27 *Sec. Litig.*, 235 F. Supp. 2d 1063, 1076 (N.D. Cal. 2002). In addition, the Complaint  
 28 erroneously seeks to hold Sonic liable as a controlling person and fails to plead with

1 particularity that the Individual Defendants exercised the requisite control. As the Ninth  
 2 Circuit has held, a defendant's status as an officer or director does not create a presumption  
 3 of control for establishing control person liability. *Paracor Fin., Inc. v. Gen. Elec. Capital*  
 4 *Corp.*, 96 F.3d 1151, 1163 (9th Cir. 1996). The Complaint's conclusory allegation—that  
 5 “[b]y reason of their positions with the Company, and their ownership of Sonic stock,  
 6 defendants had the power and authority to cause Sonic to engage in the wrongful  
 7 conduct”—makes no attempt to differentiate the various Defendants and plead with  
 8 particularity how these Defendants controlled Sonic.

9 *Fourth*, Plaintiffs' third claim alleging insider trading on the part of the Individual  
 10 Defendants in violation of Section 20A of the Exchange Act also should be dismissed. To  
 11 be liable under Section 20A, there must be an independent violation of another provision of  
 12 the securities laws. *Johnson v. Aljian*, 490 F.3d 778, 781 (9th Cir. 2007). Since Plaintiffs'  
 13 Section 10(b) and control person claims fail, this claim also must fail as to all Defendants.  
 14 In addition, Plaintiffs must also plead with particularity that they traded contemporaneously  
 15 with Defendants. *Neubronner v. Milken*, 6 F.3d 666, 670 (9th Cir. 1993). With respect to  
 16 Defendants Sauer, Ely, Marguglio, Langley and Greber, Plaintiffs also have failed to allege  
 17 that these Defendants sold stock contemporaneously with Plaintiffs. *Buban v. O'Brien*, No.  
 18 C 94-0331 FMS, 1994 WL 324093, at \*2 (N.D. Cal. June 22, 1994); *In re AST Research*  
 19 *Sec. Litig.*, 887 F. Supp. 231, 233 (C.D. Cal. 1995).

20 **IV. FRAUD PLEADING STANDARDS UNDER RULE 9(B) AND THE PRIVATE  
 21 SECURITIES LITIGATION REFORM ACT OF 1995**

22 In its last term, the United States Supreme Court clarified the standard applicable to  
 23 Rule 12(b)(6) motions. *See Bell Atl. Corp. v. Twombly*, --- U.S. ---, 127 S. Ct. 1955, 1974  
 24 (2007). Under the standard announced in *Twombly*, a plaintiff must “provide the ‘grounds’  
 25 of his ‘entitlement to relief’,” a burden that “requires more than labels and conclusions.” *Id.*  
 26 at 1965. “[A] formulaic recitation of the elements of a cause of action will not do.” *Id.* at  
 27 1974. Overruling the oft-cited standard of *Conley v. Gibson*, 355 U.S. 41 (1957), the  
 28

1 Supreme Court rejected the maxim that “a complaint should not be dismissed . . . unless it  
 2 appears beyond doubt that the plaintiff can prove no set of facts in support of his claim.”  
 3 *Twombly*, 127 S. Ct. at 1968-69. Instead, the “[f]actual allegations in the complaint must be  
 4 enough to raise a right to relief above the speculative level.” *Id.* at 1965.<sup>6</sup>

5 For private actions arising under the federal securities laws, Rule 9(b) and the  
 6 PSLRA have long established additional pleading hurdles. As one court has explained, the  
 7 Rule 9(b) pleading standard requires plaintiff to allege “the who, what, when, where, and  
 8 how: the first paragraph of any newspaper story.” *DiLeo v. Ernst & Young*, 901 F.2d 624,  
 9 627 (7th Cir. 1990). The PSLRA further requires that plaintiffs plead falsity with  
 10 particularity by “specify[ing] each statement alleged to have been misleading, the reason or  
 11 reasons why the statement is misleading, and, if an allegation regarding the statement or  
 12 omission is made on information and belief, the complaint shall state with particularity all  
 13 facts on which that belief is formed.” Section 21D(b)(1)(B); *see also Ronconi*, 253 F.3d at  
 14 429. Alleging mere conclusions is insufficient. *See, e.g., In re Daou Sys., Inc. Sec. Litig.*,  
 15 411 F.3d 1006, 1013 (9th Cir. 2005). To plead scienter under the PSLRA, plaintiffs must  
 16 “state with particularity facts giving rise to a strong inference that the defendant acted with  
 17 the required state of mind.” Section 21D(b)(2); *Daou*, 411 F.3d at 1014. In the Ninth  
 18 Circuit, scienter means at a minimum deliberate or conscious recklessness. *In re Silicon*  
 19 *Graphics Inc. Sec. Litig.*, 183 F.3d 970, 979 (9th Cir. 1999) (en banc).

20 **V. PLAINTIFFS FAIL TO STATE A SECTION 10(B) CLAIM AGAINST ALL  
 21 DEFENDANTS**

22 **A. Plaintiffs’ Complaint Fails to Plead a Strong Inference of Scienter as to  
 23 All Defendants**

24 Plaintiffs’ Complaint must be dismissed because it fails to allege specific facts that  
 25 give rise to a strong inference of scienter. In the context of Section 10(b), scienter is a  
 26 “mental state embracing intent to deceive, manipulate, or defraud.” *Silicon Graphics*, 183  
 27 F.3d at 975. Plaintiffs can only establish a strong inference of scienter if they plead facts

28 <sup>6</sup> Although *Twombly* was an antitrust case, its holding has been extended to federal  
 29 securities claims. *See, e.g., ATSI Communications, Inc. v. Shaar Fund, Ltd.*, --- F.3d ---, Nos. 05-  
 5132-cv, 05-2593-cv, 2007 WL 1989336 (2d Cir. July 11, 2007).

1 “in great detail” that “constitute strong circumstantial evidence” that Defendants knowingly  
 2 or recklessly violated Section 10(b). *Id.* at 974. A Section 10(b) claim must “contain  
 3 allegations of specific contemporaneous statements or conditions that demonstrate the  
 4 intentional or the deliberately reckless false or misleading nature of the statements when  
 5 made.” *In re Read-Rite Corp.*, 335 F.3d 843, 846 (9th Cir. 2003) (internal quotations and  
 6 citations omitted). Plaintiffs cannot “aver intent in general terms of mere ‘motive and  
 7 opportunity’ or ‘recklessness,’ but rather, must state specific facts indicating no less than a  
 8 degree of recklessness that strongly suggests actual intent.” *Silicon Graphics*, 183 F.3d at  
 9 979.

10 As the Supreme Court recently held, in order to survive a motion to dismiss, the  
 11 inference of scienter plead by plaintiffs must be “more than merely ‘reasonable’ or  
 12 ‘permissible’ – it must be cogent and compelling . . . in light of other explanations.”  
 13 *Tellabs*, 127 S. Ct. at 2510. In assessing scienter, courts must consider all reasonable  
 14 inferences that can be taken from the complaint, including inferences that are unfavorable to  
 15 plaintiffs. *See Gompper*, 298 F.3d at 897 (holding that to survive dismissal a strong  
 16 inference of scienter must be “the most plausible of competing inferences”).

17 Furthermore, courts must also consider whether plaintiffs have adequately plead  
 18 scienter as to *each* individual defendant. *See In re Silicon Storage Tech.*, No. C 05-0295,  
 19 2006 WL 648683, at \*22 (N.D. Cal. Mar. 10, 2006). Where, as here, “pleadings are not  
 20 sufficiently particularized or where, even taken as a whole, they do not raise a strong  
 21 inference of scienter, dismissal pursuant to 12(b)(6) is proper.” *In re Ditech Comms. Corp.*  
 22 *Sec. Litig.*, No. C 05-02406, 2006 WL 2319784, at \*7 (N.D. Cal. Aug. 10, 2006).

23 **1. The Complaint Fails to Plead Scienter and Fraud with  
 24 Particularity as to the Individual Defendants**

25 The scienter allegations against the Individual Defendants fall far short of meeting  
 26 the PSLRA and Rule 9(b) pleading standards. Plaintiffs generally allege that the Individual  
 27 Defendants participated in a backdating scheme that artificially inflated the value of Sonic’s  
 28 stock, but do not allege any specific facts indicating that each Defendant (1) participated in

1 approving improperly backdated options and/or (2) knew that the Company's failure to take  
 2 a compensation charge for the backdated option grants had a material effect on the  
 3 Company's financials.

4 Instead of pleading with the requisite particularity, Plaintiffs infer that simply by  
 5 virtue of their role or position in the Company, their access to information, and their routine  
 6 corporate duties, the Individual Defendants knowingly participated in a backdating scheme  
 7 and/or its concealment. Individually or collectively, such flimsy, over-generalized  
 8 allegations do not create any inference of scienter, let alone a "strong" or "cogent and  
 9 compelling" inference of scienter.

10 Moreover, Plaintiffs' unsupported and conclusory allegations regarding the role of  
 11 the Sonic officers and directors in the alleged backdating scheme are flatly contradicted by  
 12 the facts.

- 13     • By Plaintiffs' own admission, Habiger did not even become President and CEO of  
 14     Sonic *until September 2005*, well after many of the instances of alleged backdating  
 15     and misstatements occurred. Plaintiffs do not allege specific facts establishing that  
 16     Habiger intentionally or recklessly backdated stock option grants and committed  
 17     accounting violations before or after he became CEO.
- 18     • The Complaint does not allege that Ely participated in the granting or approval of  
 19     stock options and Plaintiffs do not allege specific facts that explain if or how he may  
 20     have known about the alleged backdating, the proper accounting for stock options,  
 21     and the financial misstatements.
- 22     • As the Complaint concedes, Outside Directors Marguglio, Greber, and Langley had a  
 23     limited role in granting and approving stock options. Plaintiffs do not allege facts  
 24     showing that the Outside Directors knowingly or recklessly approved backdated  
 25     stock options in violation of GAAP or that they attempted to conceal backdating or  
 26     accounting violations.
- 27     • Doris, Sauer, and Leighton are alleged to have received backdated options and to  
 28     have had a role in granting or approving stock options, but are not specifically  
 29     alleged to have knowingly or recklessly granted backdated options or made any  
 30     effort to conceal the grant of backdated options. Nor are they specifically alleged to  
 31     have knowingly committed accounting violations.

32     In sum, the general allegations that Plaintiffs make throughout their Complaint in an  
 33     effort to plead scienter are simply insufficient and are not enough to outweigh the equally  
 34     compelling inference that none of the Individual Defendants participated in deliberately  
 35     backdating option grants or had any knowledge that the Company's financial statements  
 36     were materially false or misleading.

accounted for stock option grants improperly. Without more, the limited facts that Plaintiffs have alleged in the Complaint, as set forth below, have been repeatedly rejected by courts as insufficient to raise an inference of scienter.

**a. Sonic's Restatement Does Not Give Rise to a Strong Inference of Scienter.**

Plaintiffs claim that Sonic's February 26, 2008 Restatement creates a strong inference of scienter as to Defendants' knowledge of backdating and inadequate accounting controls. Compl. ¶ 136. Plaintiffs conclude that the Restatement effectively functions as an admission by Defendants that they deliberately or recklessly violated the securities laws.

Id. ¶ 126, 136.<sup>7</sup>

But an inference of scienter does not necessarily follow from a restatement: “A plaintiff cannot allege scienter simply because [the defendant] restated its financial statements . . . . a mere violation of a generally accepted accounting principle (GAAP) or accounting rules fails to plead scienter.” *Weiss v. Amkor Tech., Inc.*, 527 F. Supp. 2d 948-49; *see also Rudolph v. UTStarcom*, No. C 07-04578, 2008 WL 1734763, at \*6 (N.D. Cal. April 14, 2008) (holding that Company’s Restatement, among other factors, was not enough to establish scienter in backdating fraud suit); *see also In re CNET Networks, Inc.*, 483 F. Supp. 2d 947, 963 (N.D. Cal. 2007) (same).

While Plaintiffs attempt to use Sonic's Restatement as an admission of fraud, as Plaintiffs grudgingly concede, Sonic's Restatement never states that intentional backdating occurred at Sonic. Compl. ¶ 71.<sup>8</sup> In fact, the Audit Committee concluded exactly the

<sup>7</sup> Plaintiffs simply conclude that “[b]ecause the restatement admits that Doris was responsible for granting these backdated options, there can be no question that he was at least deliberately reckless with respect to the statements alleged herein to be false.” Compl. ¶ 128. And without pleading more, Plaintiffs also conclude that members of the Board (comprised of Defendants Doris, Sauer, Greber, Marguglio, and Langley) knew that Doris “was issuing stock options in violation of the specific terms of shareholder approved stock option plans” and did nothing to prevent these violations. Compl. ¶ 53.

<sup>8</sup> Sonic's Restatement states that there was a lack of contemporaneous grant-specific documentation that satisfies the requirements for "measurement dates" under APB No. 25. But the absence of grant-specific documentation does not create a strong inference of scienter. It is equally plausible that there was administrative sloppiness or error, rather than any effort to intentionally conceal backdating. *See Letter from Chief Accountant to Lawrence Silva, September 19, 2006, § G, Compl. Ex. 7* (indicating that the absence of stock option documentation alone does not create an

1 opposite—that Sonic’s officers and directors had not engaged in “self dealing or favoritism”  
 2 and that the “conduct of those who administered our options plans was not intentionally or  
 3 knowing[ly] wrongful.” RJD Ex. A, at 8.

4 These findings are nearly identical to those of another audit committee in a recent  
 5 backdating case in the Northern District of California. In *CNET Networks*, 483 F. Supp. 2d  
 6 at 963, as here, the defendant company’s “special committee concluded that there was no  
 7 wrongdoing by any current or recently resigned directors or officers.” *Id.* In light of these  
 8 findings, the district court held that “absent other facts indicating fraud” plaintiffs had not  
 9 sufficiently plead facts supporting an inference of scienter. *Id.* So, too, here. Because  
 10 Sonic’s Restatement admits no intentional or deliberately reckless conduct by Defendants, it  
 11 does not create a strong inference of scienter.

12 **b. Plaintiffs Do Not Allege Facts Demonstrating that  
 13 Defendants Knowingly or Recklessly Backdated Options or  
 14 Knowingly or Recklessly Violated Accounting Rules.**

15 Plaintiffs fail to allege specific facts demonstrating that any of the Individual  
 16 Defendants knowingly: (1) backdated stock option grants; and/or (2) violated stock option  
 17 accounting rules, including APB No. 25. Without providing any specific facts, Plaintiffs  
 18 allege that because eight of Sonic’s fourteen discretionary stock grants between 1996-2004  
 19 “were purportedly granted on dates where Sonic’s stock price was trading at” a monthly  
 20 low, this pattern “can only be the result of deliberate and systematic backdating.” Compl. ¶  
 21 72. Building on this unsupported assertion, Plaintiffs then claim that not only were the  
 22 grants intentionally backdated, but Defendants knowingly violated GAAP when they made  
 23 the grants. Compl. ¶¶ 121, 122, 124, 126, 127, 129, 130.

24 First, Plaintiffs cannot establish scienter merely by alleging that because options  
 25 were granted at monthly lows, Defendants therefore participated in a backdating scheme.  
 26 Compl. ¶ 72; see *In re Hansen Nat. Corp. Sec. Litig.*, 527 F. Supp. 2d 1142, 1155 (C.D. Cal.  
 27 2007). In *Hansen*, the court held that in the absence of facts including “admissions by

28 inference of fraud). In fact, in light of the Audit Committee’s findings that there was no intentional  
 wrongdoing, this is the more cogent and compelling inference to be drawn.

1 Hansen that the stock option grants were backdated, statements by Hansen employees or  
 2 other witnesses that the stock option grants were backdated, or contemporaneous documents  
 3 demonstrating that the stock options grants were backdated,” the plaintiff had failed to  
 4 create an inference of scienter. *Id.* Likewise, in this case, Plaintiffs have not alleged any  
 5 facts indicating that stock options were intentionally backdated or that the improperly dated  
 6 grants were anything other than the result of administrative sloppiness or errors. *See*  
 7 *Rudolph*, 2008 WL 1734763 at \*6 (holding that the plaintiff’s allegations “could equally  
 8 support the inference that stock options had been backdated through innocent bookkeeping  
 9 error”).

10 But even if Plaintiffs could establish that Defendants intentionally backdated stock  
 11 options, to plead a violation of the Exchange Act, they still must plead facts showing that in  
 12 doing so, Defendants knowingly violated stock option accounting rules. *Weiss*, 527 F.  
 13 Supp. 2d at 949 (“[a]lthough allegations of accounting violations may provide some support  
 14 for scienter allegations, they must be underpinned by other particularized allegations that  
 15 defendants possessed the requisite mental state); *see also In re Worlds of Wonder Sec.*  
 16 *Litig.*, 235 F. Supp. 2d 1063, 1073 (N.D. Cal. 2002) (“even an obvious failure to follow  
 17 GAAP does not give rise to an inference of scienter”). In other words, “to plead fraudulent  
 18 intent based on GAAP violations, plaintiffs must allege facts showing that: (1) specific  
 19 accounting decisions were improper; and (2) the defendants knew specific facts at the time  
 20 that rendered their accounting determinations fraudulent.” *Morgan v. AXT, Inc.*, No. 04-  
 21 4362, 2005 WL 2347125, at \*14 (N.D. Cal. Sept. 23, 2005); *see also In re Daou Sys., Inc.*  
 22 *Sec. Litig.*, 411 F.3d 106, 1014-15 (9th Cir. 2005). Plaintiffs fail to allege any specific facts  
 23 showing that Defendants knew both that stock options had been backdated and were not  
 24 properly accounted for under GAAP. Compl. ¶ 124.

25 For instance, Plaintiffs do not plead any specific facts tending to establish: (1) that  
 26 any of the Defendants were familiar with stock option accounting rules and decided not to  
 27 follow them; or (2) that any of the Defendants believed at the time that stock option grants  
 28 were made or anytime thereafter, that the accounting used by the Company was improper or

1 illegal. *Weiss*, 527 F. Supp. 2d at 949 (“Furthermore, as pointed out by the Defendants, the  
 2 accounting rules at issue, specifically APB No. 25, are complex and require accounting  
 3 expertise and judgment.”).<sup>9</sup> Because Plaintiffs do not link the alleged violations of the stock  
 4 option accounting rules to each Defendants’ knowledge or intent, Plaintiffs have not  
 5 established a strong inference of scienter.

6 **c. Defendants’ Corporate Positions and Roles in Preparing  
 7 Routine SEC Filings and Press Releases Cannot Give Rise to  
 a Strong Inference of Scienter.**

8 Plaintiffs also claim that by virtue of their corporate positions or roles on Board  
 9 Committees at Sonic, the Individual Defendants knowingly violated Section 10(b).  
 10 Plaintiffs allege that “because of their positions with the Company,” Individual Defendants  
 11 “possessed the power and authority to control the contents of Sonic’s quarterly reports,  
 12 press releases and presentations to securities analysts” and that they had the “ability and  
 13 opportunity” to prevent their issuance or demand their correction. Compl. ¶ 68. Plaintiffs  
 14 also allege that because of their positions Defendants knew that “adverse facts” had not  
 15 been disclosed and were “being concealed from the public.” *Id.* Plaintiffs further allege  
 16 that members of the Sonic Board and the CEO, charged with administering the Company’s  
 17 stock option plans, knew or should have known that the Company’s financial statements  
 18 were false and misleading. *Id.* ¶ 121.

19 Again, without more, Plaintiffs’ attempts to associate position and authority with  
 20 knowledge fails to create a strong inference of scienter. *See Hansen*, 527 F. Supp. 2d 1158-  
 21 59 (holding in backdating suit that “the high rank of various Individual Defendants . . . is  
 22 insufficient without more to infer a strong inference of scienter”). Nor is membership on  
 23 the Board of Directors, Compensation Committee, or Audit Committee, itself probative of  
 24 whether Individual Defendants intentionally or deliberately and recklessly violated the

25  
 26 <sup>9</sup> Plaintiffs refer to the esoteric APB 25 stock option accounting rule as “perhaps the most  
 27 well known accounting rule in Silicon Valley, particularly for companies like Sonic which relied so  
 28 extensively on option grants to compensate employees.” Compl. ¶ 31. In 2008, APB 25 may be  
 closely studied and well understood by Silicon Valley executives, but it is an unwarranted and  
 unsubstantiated stretch of the imagination to argue that executives recognized its importance in the  
 late 1990s and early 2000s.

1 securities laws. “Allegations that outside directors merely held positions on committees  
 2 responsible for the preparation and disclosure of a corporation’s finances are insufficient to  
 3 set forth the circumstances constituting fraud with particularity.” *In re Oak Tech. Sec.*  
 4 *Litig.*, No. 96-20552, 1997 WL 448168, at \*11 (N.D. Cal. Aug. 1, 1997) (citing *In re*  
 5 *GlenFed, Inc.*, 60 F.3d 591, 593 (9th Cir. 1995)).

6 Finding a strong inference of scienter solely on the basis of Defendants’ positions at  
 7 the Company would eviscerate the PSLRA’s high scienter pleading standard and transform  
 8 the PSLRA into a strict liability statute. *See In re Autodesk, Inc. Sec. Litig.*, 132 F. Supp. 2d  
 9 833, 844 (N.D. Cal. 2000) (“ . . . a ruling to the contrary would eliminate the necessity for  
 10 specially pleading scienter as any corporate officer could be said to possess the requisite  
 11 knowledge by virtue of his or her position”). Sonic’s directors and senior executives cannot  
 12 be held liable for securities fraud simply because stock option granting errors occurred  
 13 during their tenures at the Company.

14 **d. Signing Forms 10-K, Forms 10-Q, and SOX Certifications  
 15 Does Not Give Rise to a Strong Inference of Scienter.**

16 The Court should also reject Plaintiffs’ attempt to create a strong inference of  
 17 scienter on the basis of Individual Defendants’ roles in signing SEC filings during the class  
 18 period.<sup>10</sup> To create an inference of scienter, Plaintiffs must not only allege that Individual  
 19 Defendants signed false filings, they must also allege that Defendants knew the statements  
 20 in the Forms 10-K, Forms 10-Q, and SOX certifications were false at the time that they  
 21 signed the filings. *See Hansen*, 527 F. Supp. 2d at 1160 (“Without allegations that each of  
 22 the Individual Defendants that signed various [Corporate] public filings knew those public  
 23 filings contained misstatements, the Individual Defendants’ signatures on those public  
 24 filings alone does not give rise to a strong inference of scienter.”); *Rudolph*, 2008 WL  
 25 1734763 at \*6 (“Similarly, the signing of quarterly certifications of financial statements  
 26

27 <sup>10</sup> Plaintiffs allege that Individual Defendants Habiger, Doris, Leighton, Greber, Marguglio,  
 28 and Langley signed false Forms 10-K and Forms 10-Q during the class period and that Defendants  
 Doris, Leighton, and Habiger attested to the accuracy of Sonic’s financial statements. Compl. ¶¶  
 120, 121, 123, 129, 60-62, 65-67.

1 mandated by the Sarbanes-Oxley Act does not, without more, support an inference of  
 2 scienter.”). The case law on this point is clear: without specific, particularized allegations  
 3 of Defendants’ knowledge or deliberate recklessness, simply signing an SEC filing that  
 4 contains errors is not enough to create a strong inference of scienter. For the reasons set  
 5 forth above in Section (b), Plaintiffs fail to allege with particularity that Defendants knew  
 6 that Sonic’s SEC filings were improper or misleading.

7 **e. Defendants Stock Sales Do Not Create a Strong Inference of  
 8 Scienter.**

9 The Individual Defendants’ stock sales also do not give rise to a strong inference of  
 10 scienter. Stock sales by corporate defendants can only lead to a strong inference of scienter  
 11 if they are “suspicious” or “unusual.” *In re Ditech Comms. Corp. Sec. Litig.*, No. C 05-  
 12 02406, 2006 WL 2319784, at \*7 (N.D. Cal. Aug. 10, 2006) (*citing In re Silicon Graphics*,  
 13 183 F.3d at 986). Moreover, to rely on stock sales as evidence of scienter, Plaintiffs “must  
 14 allege sufficient context of insider trading for use in determining whether the level of  
 15 trading is ‘dramatically out of line with [Defendants] prior trading practices.’” *Ronconi v.*  
 16 *Larkin*, 253 F. 3d 423, 436-37 (9th Cir. 2001); *see also In re Pixar Sec. Litig.*, 450 F. Supp.  
 17 2d 1096, 1004-05 (N.D. Cal. 2006).

18 Plaintiffs allege that Individual Defendants sold stock during the class period for  
 19 combined “proceeds” of \$23,509,225. Compl. ¶ 41.<sup>11</sup> But Plaintiffs do not allege facts  
 20 showing that these stock sales were “unusual” or “suspicious” either in their timing, in their  
 21 quantity relative to Defendants’ total holdings, or relative to Defendants’ past trading  
 22 behavior. *In re NextCard, Inc. Sec. Litig.*, No. C 01-21029, 2006 WL 7086663, at \*4 (N.D.  
 23 Cal. Mar. 20, 2006) (holding that Plaintiffs failed to plead scienter where they did not plead  
 24

25  
 26 <sup>11</sup> Plaintiffs allege: Defendants Doris and Sauer sold 956,000 shares of Sonic stock for  
 27 proceeds of \$17,025,285; Defendant Ely sold 28,071 shares of Sonic stock for proceeds of  
 28 \$428,083; Defendant Greber sold 40,000 shares of Sonic stock for proceeds of \$663,865;  
 Defendant Langley sold 38,000 shares of Sonic stock for proceeds of \$696,462; Defendant  
 Leighton sold 261,000 shares of Sonic stock for proceeds of \$4,440,900; and Defendant Marguglio  
 sold 20,000 shares of Sonic stock for proceeds of \$254,630. Compl. ¶ 41.

1 facts distinguishing Defendants' stock sales from other routine stock sales).<sup>12</sup> Specifically,  
 2 they do not provide any context for their analysis of these sales: they do not identify the  
 3 purchase prices of the stock sold, they do not state whether the transactions they identify  
 4 constitute all of Defendants' sales from the class period, and they fail to identify any losses  
 5 Defendants avoided. *See Ronconi*, 253 F.3d at 436. Nor do Plaintiffs tie any particular  
 6 stock transaction to any instance of alleged backdating or to any alleged misstatement to  
 7 show how the Defendants specifically benefited from the sale of Sonic stock.<sup>13</sup> Without the  
 8 necessary particularized allegations, there can be no negative inference drawn from the  
 9 Complaints' allegations about the Individual Defendants' stock sales.

10 **f. Defendants' Receipt of Allegedly Backdated Options Does  
 11 Not Create a Strong Inference of Scienter.**

12 Plaintiffs also allege that they are entitled to an inference of scienter because  
 13 Defendants Doris, Sauer, and Leighton received backdated options. Compl. ¶¶ 61-63.  
 14 Plaintiffs do not allege that Defendants Ely, Marguglio, Langley, or Greber received  
 15 backdated options. Nor do they explain why these Defendants allegedly participated in a  
 16 conspiracy that benefited only a small group of Sonic's officers and directors. But even if  
 17 they could provide such an explanation, Plaintiffs still cannot draw a negative inference  
 18 from the allegedly backdated options received by Doris, Sauer, and Leighton because they  
 19 provide no specific allegations of fraud related to these grants. Compl. ¶¶ 14, 61, 63. In  
 20 the absence of particularized allegations of fraudulent intent, "defendants' receipt and  
 21 exercise of backdated stock options" does not create a strong inference of scienter.  
 22 *Rudolph*, 2008 WL 1734763, at \*6.

23 Moreover, as an initial matter, the majority of the allegedly backdated grants to  
 24 Doris, Sauer, and Leighton are outside the class period (October 23, 2003 to May 17, 2007).

25 <sup>12</sup> See also *Ditech Comms.*, 2006 WL 2319784 at \*8 (holding that 7.1% sales of insiders' total holdings was not suspicious or unusual); *In re Copper Mountain Sec. Litig.*, 311 F. Supp. 2d 857, 875 (N.D. Cal. 2004) (holding that sales of 17% and 21% of insiders' stock was not suspicious for purposes of pleading scienter).

26 <sup>13</sup> Plaintiffs also inexplicably exclude from their analysis Defendants' stock sales during the  
 27 class period between October 23, 2002-August 4, 2003 and January 8, 2007-May 17, 2007.

1 *See* Compl. ¶¶ 11-14, 61, 63 (describing grants received by Defendants Doris, Sauer and  
 2 Leighton on July 16, 1996, July 22, 1997, November 30, 2000, July 21, 2001, December 3,  
 3 2001, March 11, 2003, and May 10, 2004).

4 The only two grants that fall within the class period are grants to Defendant Leighton  
 5 on March 11, 2003 and May 10, 2004. Compl. ¶ 129. Plaintiffs provide no particularized  
 6 allegations regarding the March 11, 2003 grant. Compl. ¶¶ 87, 129-30. As to the May 10,  
 7 2004 grant, the Complaint appears to concede that any benefit derived from this grant was  
 8 the result of an administrative error in failing to file Leighton's Form 4 on time, rather than  
 9 the result of any intentional fraudulent conduct.<sup>14</sup> Compl. ¶ 87 & n. 7. *Rudolph*, 2008 WL  
 10 1734763 at \*6. Thus, at best, Plaintiffs have alleged that of all the officers and directors,  
 11 only Defendant Leighton received one backdated option during the entire class period.<sup>15</sup>  
 12 This single allegation of receipt of a backdated grant, which appears to have involved an  
 13 administrative mistake, cannot support a strong inference of scienter.

14 **2. Plaintiffs' Failure to Plead Scienter as to the Individual Defendants  
 15 Precludes an Inference of Scienter as to the Company.**

16 In sum, Plaintiffs have failed to plead an inference of scienter as to each Individual  
 17 Defendant. *See In re Silicon Storage Tech.*, No. C 05-0295, 2006 WL 648683, at \*22 (N.D.  
 18 Cal. Mar. 10, 2006) (requiring plaintiffs to meet the scienter pleading standard for each  
 19 individual defendant). Because Plaintiffs have failed to plead scienter as to any of the  
 20 Individual Defendants, they also fail to plead scienter as to the Company. *See In re Apple*  
 21 *Computer, Inc. Sec. Litig.*, 243 F. Supp. 2d 1012, 1023 (N.D. Cal. 2002) (holding that a  
 22 corporate defendant can only be deemed to have the requisite scienter for fraud if the  
 23 individual corporate officer had the requisite level of scienter in making a misstatement);  
 24 *see also Pugh v. Tribune Co.*, Nos. 06-3898, 06-3909, 2008 WL 867739, \*10 (7th Cir. Apr.

25 <sup>14</sup> The Complaint alleges "While Sonic was routinely late filing Form 4's with the SEC relating to  
 26 stock option grants, this grant to Leighton was reported on May 12, 2004. However, by this time, Sonic  
 27 stock price had risen 5.6% from \$17.49 on Monday May 10, 2004 to \$18.53 on May 12, 2004, giving  
 Leighton an instant profit of \$104,000—or almost half of his annual salary for the fiscal year, which was  
 \$215,000." Compl. ¶ 87, n.7.

28 <sup>15</sup> Moreover, the Complaint fails to explain how the date of the filing of the Form 4 changes the  
 grant date or price.

1 2, 2008) (holding that plaintiffs failure “to establish the primary liability of any individual  
 2 defendant” prevented the court from finding for plaintiffs under a respondeat superior  
 3 theory”). Even if Plaintiffs’ failure to plead scienter did not preclude a finding of scienter  
 4 as to Sonic, Plaintiffs make no particularized allegations distinguishing the knowledge or  
 5 deliberate recklessness of the Company from that of the other Defendants.

6 **B. The Complaint Fails to Attribute Any Misstatements to Ely or the  
 7 Outside Directors.**

8 Just as the Complaint fails to plead scienter with particularity, the Complaint fails to  
 9 adequately attribute any misleading statements to Ely and the three Outside Directors.  
 10 Instead, the Complaint merely alleges that these four Defendants “participated in the  
 11 issuance of false and/or misleading statements, including the preparation of the false and/or  
 12 misleading press releases and SEC filings.” Compl. ¶¶ 64, 65, 66, & 67.

13 Notably, the Complaint does not allege that Ely signed any of the relevant SEC  
 14 filings or that he participated in any conference calls. Nor does the Complaint allege that he  
 15 was responsible for the relevant press releases. While some courts have held that a plaintiff  
 16 can assert claims against non-speaking officers based on the “group pleading doctrine,”  
 17 Plaintiffs must nonetheless satisfy the particularity requirements of Rule 9(b) and the  
 18 PSLRA under this doctrine.<sup>16</sup> *See, e.g., In re Splash Tech. Holdings, Inc. Sec. Litig.*, No. C  
 19 99-00109, 2000 WL 1727405, \*13 (N.D. Cal. Sept. 29, 2000). Specifically, Plaintiffs must  
 20 “state, with particularity, facts indicating that the individual defendant was directly involved  
 21 in the preparation of the alleged misleading statements.” *In re ESS Tech., Inc. Sec. Litig.*,  
 22 No C-02-04497, 2004 WL 3030058, at \*12 (N.D. Cal. Dec. 1, 2004).

23 <sup>16</sup> There is serious question as to whether the group pleading doctrine, which relieves a plaintiff  
 24 from alleging that each defendant actually spoke, survives the PSLRA. Although the Ninth Circuit has not  
 25 yet ruled on the viability of this doctrine, a number of district courts in this district have held that it cannot  
 26 survive the PSLRA’s requirement that “statements or omissions be set forth with particularity as to *each*  
 27 defendant[.]” *NextCard*, 2006 WL 7086663 at \*3 (Fogel, J.) (emphasis in original). Indeed, as one court  
 28 noted, the courts in this district are increasingly finding that this doctrine is contrary to the PSLRA. *In re  
 Tibco Software, Inc.*, No. 05-2146, 2006 WL 1469654, at \*27 (N.D. Cal. May 25, 2006) (Armstrong, J.).  
*See also Silicon Storage*, 2006 WL 648683 at \*22 (Hamilton, J.) (finding that this doctrine inappropriate in  
 light of the pleading standards imposed by the PSLRA); *Nextcard*, 2006 WL 7086663, at \*3 (same); *In re  
 Netopia, Inc. Sec. Litig.*, No. C-04-03364, 2005 WL 3445631, at \*6 (N.D. Cal. Dec. 15, 2005) (Whyte, J.)  
 (same). We respectfully request that this Court join these courts and reject the group pleading doctrine.

1       Here, the Complaint fails to provide any particulars regarding Ely's involvement in  
 2 the preparation of any of the challenged statements. To the contrary, the Complaint simply  
 3 relies on boilerplate allegations that he "participated in the issuance of false and/or  
 4 misleading statements"—allegations that courts have repeatedly held to be insufficient to  
 5 invoke the group pleading doctrine. *See e.g., In re Tibco Software, Inc.*, No. 05-2146, 2006  
 6 WL 1469654, at \*28 (N.D. Cal. May 25, 2006)(conclusory allegations that "defendants  
 7 were involved in drafting, producing, reviewing and/or disseminating the false and  
 8 misleading statements" insufficient); *Splash Tech. Holdings*, 2000 WL 17274905 at \*14  
 9 ("conclusory comment" that "defendants participated in the drafting and reviewing of the  
 10 misleading statements" insufficient). Accordingly, the Complaint fails to plead any  
 11 misstatement by Ely and Plaintiffs' Section 10(b) claim against him must be dismissed. *See*  
 12 *Medimatch, Inc. v. Lucent Tech., Inc.*, 120 F. Supp. 2d 842, 856 (N.D. Cal. 2000)  
 13 (dismissing Section 10(b) claim where plaintiff failed to allege any misstatement made by  
 14 defendant).

15       As to the Outside Directors, the Complaint also alleges that they signed the allegedly  
 16 false Forms 10-K. But that is not enough. As courts have repeatedly held, the mere fact  
 17 that an outside director signed a Form 10-K is insufficient to make the outside director  
 18 liable for its contents. *See, e.g., In re Gupta Corp. Sec. Litig.*, 900 F. Supp. 1217, 1241  
 19 (N.D. Cal. 1994); *In re Ross Sys. Sec. Litig.*, No. C-94-0017, 1994 WL 583114, at \*6 (N.D.  
 20 Cal. July 21, 1994). Instead, plaintiffs must plead that those directors were involved not  
 21 only in the day-to-day activities, management, or control of the company, but also in the  
 22 preparation of the allegedly misleading statements in particular. *See e.g., Tibco Software*,  
 23 2006 WL 1469654, at \*28; *Ross Sys. Sec. Litig.*, 1994 WL 583114 at \*6; *In re Syntex Corp. Sec. Litig.*, 855 F. Supp. 1086, 1100 (N.D. Cal. 1994). This Complaint pleads neither. It  
 25 does not plead that the Outside Directors were involved in the day-to-day activities of  
 26 Sonic. Nor does it plead specific facts establishing that they were involved in the  
 27 preparation of the particular misstatements at issue. Accordingly, Plaintiffs' Section 10(b)  
 28 claim against the Outside Directors also should be dismissed.

1           **C.     The Court Should Dismiss Any Claim Plaintiffs Purport to State for**  
 2           **“Scheme” Liability.**

3           Plaintiffs also fail to state a Section 10(b) claim under “scheme” liability. Rule 10b-  
 4        5 has three subsections. The section most frequently used is subsection (b), which imposes  
 5        liability for making false statements.<sup>17</sup> The bulk of Plaintiffs’ Complaint appears to be  
 6        grounded in this subsection: Plaintiffs spend nearly fifty paragraphs listing allegedly false  
 7        statements made by Defendants. Compl. ¶¶ 70-114. Because the Complaint fails to  
 8        attribute any of these misstatements to Ely and the Outside Directors for the reasons  
 9        discussed above, they may be liable under Section 10(b) only if Plaintiffs have stated a  
 10       claim under subsections (a) and (c), which together create what has become known as  
 11       “scheme” liability. *E.g., Schnall v. Annuity & Life Re (Holdings)*, No. 02-CV-2133, 2006  
 12       WL 2331138, at \*6 (D. Conn. Aug. 10, 2006) (describing and dismissing plaintiff’s scheme  
 13       liability claim under Rule 10b-5(a) and (c)); Compl. ¶ 198 (alleging that Defendants  
 14       violated all three subsections of Rule 10b-5).

15           In order to allege scheme liability, Plaintiffs must allege acts and conduct beyond  
 16        misrepresentations. *See, e.g., In re Redback Networks, Inc. Sec. Litig.*, No. C03-5642 JF  
 17        (HRL), 2006 WL 1805579, at \*5 (N.D. Cal. Mar. 20, 2006) (“despite the fact that Plaintiffs  
 18        attempt to characterize their second claim as a ‘manipulative act’ claim rather than a  
 19        ‘misstatements and omissions’ claim, the Court will treat claim two as duplicative of

20           <sup>17</sup> Rule 10b-5 states as follows:

21           It shall be unlawful for any person, directly or indirectly, by the use of any means of  
 22        instrumentality of interstate commerce, or of the mails or of any facility of any national  
 23        securities exchange,

24           (a) To employ any device, scheme, or artifice to defraud,

25           (b) To make any untrue statement of a material fact or to omit to state a material fact  
 26        necessary in order to make the statements made, in the light of the circumstances under  
 27        which they were made, not misleading, or

28           (c) To engage in any act, practice or course of business which operates or would operate as a  
 29        fraud or deceit upon any person, in connection with the purchase or sale of any security.

30           17 C.F.R. § 240.10b-5.

[misstatements and omissions] claim"); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177 (2d Cir. 2005) (rejecting scheme liability when "the sole basis for such claims is alleged misrepresentations or omissions"); *In re Recoton Corp. Sec. Litig.*, 358 F. Supp. 2d 1130, 1138 n. 4 (M.D. Fla. 2005) (refusing to analyze scheme liability claims that were based on alleged misrepresentations and omissions). Instead, a plaintiff must "allege that the defendant engaged in a manipulative or deceptive scheme or conduct that encompasses acts beyond misrepresentations." *In re Royal Dutch/Shell Transport Sec. Litig.*, No. 04-374, 2006 WL 2355402, at \*8 (D.N.J. Aug. 14, 2006) (collecting authorities); *see also JHW Greentree Capital, L.P. v. Whittier Trust Co.*, No. 05 Civ.2985 HB, 2005 WL 3008452, at \*7 n.11 (S.D.N.Y. Nov. 10, 2005) (plaintiffs failed to allege scheme liability where they did not plead any allegations against the defendant personally, "apart from her alleged misrepresentations and omissions"). Plaintiffs' scheme allegations fall far short of this standard.

There is no question that Plaintiffs' Section 10(b) claim is based on purported misstatements. As noted above, the Complaint devotes nearly fifty paragraphs to listing the alleged misstatements by the Defendants. Indeed, Plaintiffs' entire case relies on the fact that there was a Restatement, which they claim is implicit acknowledgement of misrepresentations.

Although the Complaint loosely alludes to a "fraudulent scheme," in Plaintiffs' own words, the crux of the alleged fraudulent scheme "was a practice whereby defendants knowingly manipulated stock option grants to the Company's officers, directors and employees in order to provide the recipients with a more profitable exercise price while under-reporting the Company's expenses and thereby overstating the Company's reported earnings or understating the Company's reported loss." Compl. ¶ 2. In other words, Defendants are accused of getting the accounting for option grants wrong on the Company's financial statements. These allegations do not rescue the Complaint as they do little more than recast the misrepresentation claim as a claim for scheme liability. *Royal Dutch/Shell Transp.*, 2006 WL 2355402, at \*8; *JHW Greentree Capital*, 2005 WL 3008452, at \*7

1 n.11.<sup>18</sup> Because Plaintiffs fail to allege any misconduct beyond the alleged misstatements,  
 2 the Court should dismiss any claim under subsections (a) and (c) of Rule 10b-5.

3 **VI. PLAINTIFFS FAIL TO PLEAD A SECTION 20(A) “CONTROL PERSON”  
 4 LIABILITY CLAIM AGAINST ALL DEFENDANTS**

5 The Complaint also seeks to hold *all* Defendants (including the Company) liable as  
 6 “controlling persons” under Section 20(a) of the Exchange Act. Compl. ¶¶ 210-211. To  
 7 plead control person liability under Section 20(a), a plaintiff must allege (1) a primary  
 8 violation of the securities laws and (2) “that the defendant exercised actual power or control  
 9 over the primary violator.” *Howard v. Everex Sys., Inc.*, 228 F.3d 1057, 1065 (9th Cir.  
 10 2000). “Plaintiff’s section 20(a) claim is an allegation of fraud. Allegations of fraud must  
 11 be pled with particularity,” therefore, “plaintiff must plead the circumstances of the control  
 12 relationship with sufficient particularity to satisfy rule 9(b).” *Howard v. Hui*, No. C-92-  
 13 3742-CRB, 2001 WL 1159780 (N.D. Cal. Sept. 24, 2001) (internal citations omitted); *see*  
 14 also *In re Ramp Networks, Inc. Sec. Litig.*, 201 F. Supp. 2d 1051, 1063 (N.D. Cal. 2002)  
 15 (“Where a plaintiff alleges a Section 20(a) claim based on an underlying violation of section  
 16 10(b) of the 1934 Act, the pleading requirements for the Section 20(a) claim are the same as  
 17 they are for the Section 10(b) claim.”). Plaintiffs’ Section 20(a) claim must be dismissed  
 18 for three reasons.

19 *First*, because the Complaint fails to adequately allege a primary violation under

20 <sup>18</sup> *Simpson v. AOL Time Warner Inc.* was the Ninth Circuit’s leading authority on scheme liability.  
 21 *Simpson* requires a plaintiff to plead that a defendant’s conduct “had the principal purpose and effect of  
 22 creating a false appearance in deceptive transactions” as part of a scheme to defraud. *Simpson v. AOL Time*  
 23 *Warner Inc.*, 452 F.3d 1040, 1052 (9th Cir. 2006) (judgment vacated in *Simpson v. Homestore.com, Inc.*, 519  
 24 F.3d 1041 (9th Cir. 2008)). Following the Supreme Court’s *Stoneridge* decision, however, the Ninth Circuit  
 25 vacated this opinion and remanded the case to the district court for further proceedings. Thus, until the 9th  
 26 Circuit reaffirms its holding, it appears that *Simpson* is no longer good law.

27 But even if the *Simpson* “purpose and effect” standard still applies, Plaintiffs also fail to meet that  
 28 standard here. According to Plaintiffs, the “principal purpose” of Defendants’ conduct was the realization of  
 a *direct financial benefit* to themselves and to other employees the Company sought to recruit or retain by  
 issuing in the money grants. *See, e.g.*, Compl. ¶¶ 4, 39. Thus the “principal purpose and effect” that  
 emerges from the Complaint allegations is not the “creat[ion of] a false appearance” with respect to some  
 item in Sonic’s financial statements, as *Simpson* requires. 452 F.3d at 1052. Rather, the “principal purpose  
 and effect” of the alleged misconduct is something much simpler: the awarding of lucrative stock option  
 grants to Company executives and sought-after employees. Accordingly, Plaintiffs fail to meet the *Simpson*  
 standard even if it continues to be the standard in this Circuit.

1 Section 10(b) for the reasons set forth above, it too fails to plead control person liability  
 2 under Section 20(a). *In re U.S. Aggregates, Inc. Sec. Litig.*, 235 F. Supp. 2d 1063, 1076  
 3 (N.D. Cal. 2002) (dismissing Section 20(a) claim where plaintiff failed to allege an  
 4 underlying primary violation).

5 *Second*, in yet another attempt to overreach, the Complaint seeks to hold Sonic liable  
 6 both as a controlling person and as a controlled person. In asserting the Section 20(a) claim  
 7 against all Defendants, the Complaint states: “By reason of their positions with the  
 8 Company, and their ownership of Sonic stock, defendants had the power and authority to  
 9 cause Sonic to engage in the wrongful conduct complained of herein. Sonic controlled  
 10 defendants and all of its employees. By reason of such conduct, defendants named herein  
 11 are liable pursuant to Section 20(a) of the Exchange Act.” Compl. ¶ 211. This allegation  
 12 further illustrates Plaintiffs’ circular approach to pleading—they ask this Court to find that  
 13 the Individual Defendants controlled Sonic, and that, Sonic, in turn, controlled the  
 14 Individual Defendants. Like a cat chasing its own tail, this allegation is nonsensical: Sonic  
 15 is an entity that cannot control the actions of individuals. Therefore, the Section 20(a) claim  
 16 against Sonic must be dismissed.

17 *Third*, the Section 20(a) claim against the Individual Defendants must also be  
 18 dismissed because the Complaint fails to plead with particularity that they exercised the  
 19 requisite control. As an initial matter, the Complaint’s conclusory allegation—that “[b]y  
 20 reason of their positions with the Company, and their ownership of Sonic stock, defendants  
 21 had the power and authority to cause Sonic to engage in the wrongful conduct”—makes no  
 22 attempt to differentiate among the various Defendants or plead how they individually  
 23 controlled Sonic. As the Ninth Circuit has held, a defendant’s status as officer or director  
 24 does not create any presumption of control for establishing control person liability. *Paracor*  
 25 *Fin., Inc. v. Gen. Elec. Capital Corp.*, 96 F.3d 1151, 1163 (9th Cir. 1996). Nor is Plaintiffs’  
 26 reliance on Defendants’ ownership of Sonic stock sufficient. Though lengthy, nowhere in  
 27 its 217 paragraphs does the Complaint allege what percentage of Sonic the Individual  
 28 Defendants own. It is inconceivable that any level of ownership of Sonic stock suffices for

1 control person liability.<sup>19</sup>

2 Courts have rejected similarly undifferentiated allegations of control. In *Hansen*, the  
 3 Complaint likewise alleged that “[b]y virtue of their high-level positions, and their  
 4 ownership and contractual rights, participation in and/or awareness of the Company’s  
 5 operations and/or intimate knowledge of the false financial statements ..., the Individual  
 6 Defendants had the power to influence and control ... the decision making of the Company  
 7 ...” *Hansen*, 527 F. Supp. 2d at 1163. The Court there held that “this boilerplate allegation  
 8 is insufficient to state a claim for control person liability.” *In re Hansen Nat. Corp. Sec.*  
 9 *Litig.*, 527 F. Supp. 2d 1142, 1163 (C.D. Cal. 2007) (quoting *In re Digital Island Sec. Litig.*,  
 10 223 F. Supp. 2d 546 (D. Del. 2002), *aff’d* 357 F.3d 322 (3d Cir. 2004) (“[E]ven a CEO is  
 11 not automatically a ‘controlling person’ under Section 20(a).”)). Here, too, the Section  
 12 20(a) claim must be dismissed against all Defendants.

13 **VII. THE COMPLAINT FAILS TO STATE SECTION 20A INSIDER TRADING**  
**CLAIMS**

14 Plaintiffs’ Section 20A insider trading claims against Doris, Sauer, Ely, Greber,  
 15 Langley, Leighton and Marguglio also should be dismissed. Compl. Third Claim for Relief.  
 16 To be liable under Section 20A, there must be an independent violation of another provision  
 17 of the securities laws.<sup>20</sup> *Johnson v. Aljian*, 490 F.3d 778, 781, 785 (9th Cir. 2007) (holding  
 18 that plaintiff must “plead and prove the essential elements of a predicate violation” of the  
 19 securities laws to pursue a 20A claim); *In re Verifone Securities Lit.*, 784 F. Supp. 1471,  
 20 1488 (N.D. Cal. 1992) (same). Because Plaintiffs fail to properly plead that the Individual  
 21

22  
 23 <sup>19</sup> And in any event, courts have held that even significant stock ownership is insufficient to  
 24 establish control. *See, e.g., Howard*, 2001 WL 1159780 (finding that defendants’ 20% ownership in the  
 25 underlying entity, together with numerous other control allegations, insufficient to plead a Section 20(a)  
 26 claim); *In re Splash Tech. Holdings, Inc. Sec. Litig.*, No. C 00-00109, 2000 WL 1727405, (N.D. Cal. 2000)  
 27 (20% ownership insufficient to plead Section 20(a) controlling person liability).

28 <sup>20</sup> Section 20A of the Exchange Act provides:

26 Any person who violates any provision of this chapter or the rules or regulations thereunder  
 27 by purchasing or selling a security while in possession of material, nonpublic information  
 28 shall be liable to any person who, contemporaneously with the purchase or sale of securities  
 that is the subject of such violation, has purchased or sold securities of the same class.

15 U.S.C. § 78t-1(a).

1 Defendants violated any securities laws, Plaintiffs also fail to allege that the Individual  
 2 Defendants violated Section 20A. *Johnson v. Aljian*, 490 F.3d at 781; *In re Verifone Sec.*  
 3 *Lit.*, 784 F. Supp. at 1488.

4 Second, Plaintiffs must also plead with particularity that they traded  
 5 contemporaneously with Defendants. *Neubronner v. Milken*, 6 F.3d 666, 670 (9th Cir.  
 6 1993). Sauer, Ely and Marguglio are not alleged to have sold stock contemporaneously  
 7 with Plaintiffs, and thus, the claims against these Defendants must be dismissed. *See* Third  
 8 Claim for Relief; Compl. ¶¶ 212-217. As to Langley and Greber, although the Ninth Circuit  
 9 has not squarely address the issue of what constitutes “contemporaneous” trading, district  
 10 courts in this Circuit have adopted a restrictive reading of this term, at least with respect to  
 11 shares like Sonic’s that are heavily traded on a national exchange. *See, e.g., Alfus v.*  
 12 *Pyramid Tech. Corp.*, 745 F. Supp. 1511, 1522 (N.D. Cal. 1990); *In re AST Research Sec.*  
 13 *Litig.*, 887 F. Supp. 231, 233 (C.D. Cal. 1995). Following this approach, numerous courts  
 14 have held that only purchases and sales on the same day are “contemporaneous.” *Buban v.*  
 15 *O’Brien*, No. C 94-0331 FMS, 1994 WL 324093, at \*2 (N.D. Cal. June 22, 1994); *In re AST*  
 16 *Research Sec. Litig.*, 887 F. Supp. at 233. These courts reason that, because the  
 17 contemporaneous trading requirement functions as a substitute for privity, in a heavily  
 18 traded security, plaintiff could not have purchased defendant’s shares where the trades are  
 19 more than one day apart.<sup>21</sup> *Buban*, 1994 WL 324093, at \*2; *In re AST Research Sec. Litig.*,  
 20 887 F. Supp. at 233. The same holds true here. Because Plaintiffs only made trades on  
 21 February 19, 2004, Plaintiffs lack standing to bring Section 20A claims against Langley and  
 22 Greber, neither of whom made any sales on that date. Compl. ¶ 214.

23 **VIII. CONCLUSION**

24 For the foregoing reasons, the Complaint should be dismissed in its entirety.

25  
 26  
 27 <sup>21</sup> Though one Northern District court stated that the contemporaneous requirement is not met “if  
 28 plaintiff’s trade occurred more than a few days apart from defendants’ transactions,” *Alfus v. Pyramid Tech.*  
*Corp.*, the court relied on one authority that held that two days was not contemporaneous. 745 F. Supp.  
 1511, 1522 (N.D. Cal. 1990).

1 DATED: May 23, 2008

Respectfully submitted,

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3

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